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DECLARATION OF

STANLEY M. BESEN AND STEVEN R. BRENNER

Charles River Associates Incorporated

March 20, 2000

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STANLEY M. BESEN AND STEVEN R. BRENNER*

I. INTRODUCTION AND EXECUTIVE SUMMARY

1. The structure of the long distance telephone industry has changed significantly in the past half dozen years, yet one would be hard pressed to learn that fact by reviewing most of the comments filed in this proceeding. Despite the entry of a large number of new long distance carriers, despite the considerable long distance networks that are being constructed by new entrants, and despite the substantial amount of business that new carriers have acquired, the comments read for the most part as if only three long distance carriers continue to serve long distance users. Because the comments give short shrift to recent developments, they overstate the likely competitive effects of a merger between MCI WorldCom and Sprint. New carriers with substantial networks would play a central role in constraining any attempt by the merged entity to raise prices. These carriers could bring more capacity on line in response to an attempted price increase and sell the resulting increase in output to final users. Alternatively, these carriers could sell the additional output, or access to the additional capacity, to other carriers who would themselves sell to final users. In either case, the expansion of output would significantly limit the ability of the merged entity to raise prices.

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* Statements of qualifications were attached to our Declaration previously submitted in this proceeding: Declaration of Stanley M. Besen and Steven R. Brenner, November 17, 1999 (hereafter "Besen and Brenner Declaration"), filed as Appendix B to *In re Applications of Sprint Corporation, Transferor, and MCI WorldCom, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Authorizations Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 1, 21, 24, 25, 63, 73, 78, 90, and 101*, FCC, CC Docket No. 99-333.

2. The ability of new long distance carriers to compete effectively is not a mere theoretical possibility. A number of carriers—including Qwest, IXC (now Broadwing), Level 3, Enron, Williams, and Frontier—are investing in large nationwide communications networks, and significant investments are also being made in regional networks. Independent forecasts indicate that the bandwidth supplied in the aggregate by these new networks will far exceed that supplied by a merged MCI WorldCom-Sprint in only a few years. Emerging carriers would not have made these investments had they not expected to be able to compete effectively in the provision of telecommunications services. In addition, these carriers, and those that employ their capacity or resell their services, already have captured a significant amount of long distance business. These facts together provide marketplace evidence of the present and future competitive significance of these carriers, yet this evidence is largely overlooked in this proceeding's comments.

3. Moreover, virtually all forecasts for the near term indicate that the combined market share of AT&T, MCI WorldCom, and Sprint will continue to erode as a result of the growth of new carriers and the entry of RBOCs into the provision of long distance service. Not only will the merged entity face substantially more competition than existed only a few short years ago, but it will also soon face additional competition. The competitive significance of a merger between MCI WorldCom and Sprint cannot be evaluated properly without taking these developments into account.

4. Opponents of the merger attempt to argue that the emerging carriers cannot compete effectively for mass market customers because MCI WorldCom and Sprint, as well as AT&T, have created brand loyalty for their services with advertising, while the emerging carriers lack brand name recognition and currently spend far less on brand

advertising. In the first place, these claims are inconsistent with the observed ability of the emerging carriers to capture residential and small business customers. Emerging carriers have employed a variety of successful marketing strategies, including some that are alternatives to developing a well-known brand: for example, selling services through affinity groups, or associating themselves with brands from outside the long distance industry, such as Talk.com's highly successful affiliation with AOL.

5. The claims also are inconsistent with data that show both the high customer turnover rates experienced by the so called "branded" carriers and the extent to which customers shift between AT&T, MCI WorldCom, and Sprint and the emerging carriers. These data indicate that nearly one-half of the households using MCI WorldCom or Sprint at any given time for most of their interLATA calling will switch to another carrier as their main supplier within 12 months. Approximately one-third of the households that stop using MCI WorldCom or Sprint dial-1 service as their main supplier of interLATA calling switch to the service of an emerging carrier, and an even larger percentage switch to a service not carrying the MCI WorldCom, Sprint, or AT&T brand name. Indeed, households make these switches to emerging carriers in greater numbers than would be predicted based on their current shares of residential service. Finally, more than one-third of households use an emerging carrier as this main supplier of interLATA calling for at least one month in a 12-month period.

6. Opponents of the merger point to the total spending on advertising of MCI WorldCom, Sprint, and AT&T. Aggregate information, however, obscures the fact that much of the spending on advertising by MCI WorldCom and Sprint is not on branded,

residential long distance service, but rather on, among other things, MCI WorldCom's dial around services that do not identify its corporate brand and on Sprint's PCS offerings.

7. A number of parties attempt to argue that the services provided by the merging parties are each the "best substitutes" for one another. This argument is inconsistent with the marketing behavior of the merging parties and is not supported by data on the extent to which residential customers shift from MCI WorldCom and Sprint, as well as from AT&T, to emerging carriers. If anything, these patterns of shifting indicate that the services of the emerging carriers are closer substitutes for both the MCI WorldCom and Sprint branded services than these latter services are for each other.

8. Opponents of the merger also have presented the results of a statistical analysis that claims to show that the merging firms each already possess substantial market power and that the merger would result in increased prices. However, the estimates of demand elasticities advanced in support of these propositions imply markups of price over cost for MCI WorldCom and Sprint, and especially for AT&T, that are so implausibly high, and so variable from one carrier to another, that the Commission cannot credit them.

9. In addition, there appear to be a number of technical difficulties with the underlying statistical analysis. For example, it is very doubtful that the values for prices used to estimate the responses of demand to price accurately measure the prices to which consumers respond, in part because the analysis apparently understates promotional offers—such as free minutes or cash payments—that carriers use to attract additional customers. In addition, the analysis assumes (implausibly) that consumers respond fully to changes in prices within a single month. As a result, neither the statistical estimates of

demand conditions, nor the projected price effects of the merger based on these estimates, should be considered reliable.

10. Opponents similarly understate the competitive significance of emerging carriers in selling to business customers. The opponents' claims ignore the growing success new carriers are having in capturing business customers, including success in providing precisely the services—among them ATM and frame relay—that the traditional carriers are claimed to dominate. Opponents also denigrate the significance of emerging carriers by claiming that they lack the sales forces necessary to compete effectively in selling to larger business customers. These claims are made despite the enormous networks that have been, and are being, built by these carriers, in large measure to serve the business market, and despite the accompanying sales organizations that the carriers are developing.

11. Emerging carriers have recently been quite successful in attracting business customers from the older long distance carriers, including significant amounts of business from some of the largest U.S. companies, and independent analysts expect this trend to continue. These developments are completely ignored by the opponents of the merger and, thus, the opponents overstate the merger's impact on competition.

II. NATIONAL AND REGIONAL FIBER NETWORKS

12. As we pointed out in our previous Declaration, one of the most important forces for change in the supply of long distance service has been the rapid increase in the number of emerging carriers that have been constructing, or otherwise gaining control of, national or major regional networks. The number of carriers that control fiber networks has increased substantially in only the last few years, and the reach of those networks has been

expanding. Our previous Declaration provided the following information on these networks:[1]

- **Qwest**: 18,815 route miles connecting 150 U.S. cities
- **Williams**: 26,000 route miles planned for the end of 1999 with an additional 6,000 route miles planned by the end of 2000
- **IXC/Broadwing**: 15,000 route miles to be completed by the end of 1999
- **Frontier**: 12,000 route miles deployed by the end of 1998 and 20,000 route miles connecting 120 U.S. cities planned by completion
- **Level 3**: planned 16,000 route miles expected to be 94 percent complete by the end of 2000
- **Caprock**: regional network in Texas and neighboring states with a planned 6,100 route miles by the end of 2000
- **MacLeodUSA**: regional network currently covering 9,400 route miles in 12 Midwest and Rocky Mountain states
- **GST Telecom**: regional network in the West with 6,600 operational route miles expected by the end of 1999.

13. As long as this list is, it is still not complete. Additional carriers are either building or acquiring control of national fiber networks.

[1] Besen and Brenner Declaration, ¶¶28-35.

- **Teleglobe**: On January 25, 2000, Teleglobe, which had acquired Excel Communications in November 1998, announced that it was adding 14,000 route miles of dark fiber across the U.S. that is capable of activation to at least 3.2 terabits per second. This network expansion is part of the company's GlobalSystem initiative to expand its global network reach. Teleglobe is acquiring the fiber, together with associated collocation space, for twenty years in an agreement with Williams Communications; the agreement also provides Teleglobe with access to interim capacity until its own dark fiber is activated.[2]

- **Enron**: Enron is building a national fiber backbone that is expected to cover about 20,000 route miles during the year 2000 and that will operate at speeds up to 10 gigabits per second (OC-192).[3]

- **Cable & Wireless**: Cable & Wireless announced in April 1999 that it had entered into an agreement with Level 3 to purchase 15,000 route miles of dark fiber in the U.S. It simultaneously announced the acquisition of both routers and ATM switches, and that it expected to complete its network during 2001. The U.S. network will be linked with Cable & Wireless' global network in both Asia and Europe.[4]

- **GTE**: In December 1999, GTE announced completion of its 17,000 mile nationwide fiber backbone network, the Global Network Infrastructure (GNI),

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[2] http://www.teleglobe.com/template/press/presspres.cfm?ilang=eng&itopic=General&itopicclass=News&iPeriod=Q-1/2000&iPressid+n2000-01-25, visited January 28, 2000.

[3] http://www.enron.net/about/, visited February 27, 2000.

[4] http://www.cableandwireless.com/press/1999/p99apr13.htm, visited February 17, 2000.

which it claimed was the industry's first fully activated network designed with a ring architecture that increases network reliability and decreases the risk of service outages.[5]

14. In addition, carriers that the earlier Besen and Brenner Declaration identified as controlling fiber networks continue to announce extensions of those networks.

- **Qwest**: Announced in February 2000 that it had completed a 1,000 mile expansion of its network from Denver to Dallas, and that its North American network now covered 25,500 miles.[6]

- **Williams**: Announced in February 2000 a three-year plan to expand its network by extending facilities into 50 urban areas as well as a plan to complete a 33,000 mile long-haul fiber network by the end of 2000. This extension into urban areas will complement existing agreements with local providers' facilities in other U.S. cities.[7]

- **IXC/Broadwing**: Announced in January 2000 that it had added 6,000 route miles to its network during 1999, which finished the year with 15,700 route miles. The network now reaches 63 top-100 cities, up from 52 in 1998.[8]

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[5] http://www.gte.com/AboutGTE/NewsCenter/News/Releases/GN12.html, visited February 27, 2000.

[6] http://www.qwest.com/press/story.asp?id=190, visited February 23, 2000.

[7] http://www.williamscommunications.com/newsroom/newsreleases/2000/021000a.html, visited February 23, 2000.

[8] http://investor.broadwing.com/news/20000127-13630.htm, visited March 13, 2000.

15. These carriers have constructed their networks in some cases by laying fiber, and in others by acquiring the fiber assets through long-term leases or other arrangements. Carriers that have acquired fiber have done so in ways that give them long-term control of the basic fiber assets. It is the control of these network assets that has economic significance, not the identity of the carrier that constructed the assets or the identity of the carrier with legal title to them. The carriers that have constructed fiber typically have done so with every intention of operating their own networks, supplying dark fiber to others, or both, and have sized their installed fiber to allow them to pursue both kinds of commercial opportunities.

16. The potential capacity of the new fiber networks already is very great and it will increase in the future. Expected continuing advances in dense wave division multiplexing (DWDM) will allow further increases in the bandwidth capacity of installed physical fiber. Furthermore, several carriers have designed the construction of their networks to permit the installation of additional fiber at relatively low cost. For example, Qwest, Williams, and Level 3 have buried empty conduit alongside conduit now carrying fiber.[9] Whenever there is sufficient demand, additional fiber can be pulled through the empty conduit without incurring the costs or delays involved in burying new cable or acquiring rights of way.

17. These developments reinforce the point that the amount of fiber capacity, and the number of carriers that control that capacity, continues to expand. Particularly striking is the rapid decrease that is expected to occur in the next few years in the proportion of fiber

[9] Qwest and Williams are reported to have installed two conduits over most of their routes, while Level 3 is installing 10 to 12 conduits. See http://www.level3.com/Content/1,1233,us|news|_smartmoney,00.html, visited March 1, 2000.

capacity controlled by AT&T, MCI WorldCom, and Sprint. Credit Suisse/First Boston has estimated the supply of bandwidth, defined in terabit-miles, controlled by various carriers from 1999 through 2003.[10] These estimates, which are reproduced in Table 1, predict that the proportion of bandwidth supply controlled by AT&T, MCI WorldCom, and Sprint will decline from about 63 percent in 1999 to less than 10 percent in 2003. During that same period, the proportion of the supply of bandwidth controlled by MCI WorldCom and Sprint is estimated to decline from about 33 percent to less than 1 percent.

18. Even if these estimates substantially understate the share of capacity that would be controlled by the merged entity, they demonstrate the capability of the emerging carriers to expand their capacity dramatically, in both absolute and relative terms. As can be seen in Table 1, Credit Suisse/First Boston estimates that the capacities of the MCI WorldCom and Sprint networks will grow at compound annual rates of less than 10 percent over the period 1999–2003. During the same period, the rate of growth projected for Qwest is 171 percent, which is the smallest annual growth rate projected for any of the seven emerging carriers examined. Clearly, underlying fiber capacity, and access to that capacity, is evidence of the significant changes in the supply of long distance services that are increasing the number of competitors with extensive network resources.

[10] Daniel P. Reingold et al., *U.S. Telecom Services Wireline*, Credit Suisse/First Boston, January 6, 2000, Exhibit 16a: "Estimated Supply in Terabit-Miles," p. 34.

Table 1

Estimated Supply of Bandwidth, in Terabit-Miles

	1999E		2000E		2001E		2002E		2003E		
Network	**Total Annual Capacity**	**Share of Total Capacity**	**Total Annual Capacity**	**Share of Total Capacity**	**Total Annual Capacity**	**Share of Total Capacity**	**Total Annual Capacity**	**Share of Total Capacity**	**Total Annual Capacity**	**Share of Total Capacity**	**'99-'03 CAGR**
AT&T	180,333,686	30.1%	214,349,698	17.1%	348,813,850	9.8%	808,742,630	8.1%	2,619,132,106	8.8%	95.2%
MCI WorldCom	138,017,117	23.0%	149,265,512	11.9%	161,430,652	4.5%	174,587,250	1.7%	188,816,111	0.6%	8.2%
Sprint	62,498,317	10.4%	67,591,930	5.4%	73,100,672	2.1%	79,058,377	0.8%	85,501,635	0.3%	8.2%
MCIW & Sprint Subtotal	***200,515,434***	***33.4%***	***216,857,442***	***17.3%***	***234,531,324***	***6.6%***	***253,645,627***	***2.5%***	***274,317,746***	***0.9%***	***8.2%***
Qwest	117,590,584	19.6%	235,181,168	18.8%	705,543,504	19.8%	2,116,630,511	21.2%	6,349,891,533	21.4%	171.1%
Global Crossing/Frontier	36,913,069	6.2%	77,927,589	6.2%	233,782,768	6.6%	701,348,304	7.0%	2,104,044,912	7.1%	174.8%
GTE	3,906,145	0.7%	33,202,231	2.6%	99,606,693	2.8%	298,820,079	3.0%	896,460,238	3.0%	289.2%
BroadWing/IXC	22,257,213	3.7%	67,966,920	5.4%	203,900,760	5.7%	611,702,280	6.1%	1,835,106,841	6.2%	201.3%
Level 3	8,749,764	1.5%	249,993,269	19.9%	1,199,967,692	33.7%	3,599,903,075	36.1%	10,799,709,224	36.4%	492.7%
Touch America	14,322,531	2.4%	64,451,390	5.1%	247,063,660	6.9%	741,190,981	7.4%	2,223,572,944	7.5%	253.0%
Williams	15,038,658	2.5%	94,333,398	7.5%	283,000,193	8.0%	849,000,579	8.5%	2,547,001,736	8.6%	260.7%
Total Annual Capacity	**599,627,085**	**100.0%**	**1,254,263,105**	**100.0%**	**3,556,210,445**	**100.0%**	**9,980,984,066**	**100.0%**	**29,649,237,281**	**100.0%**	**165.2%**

Source: Daniel P. Reingold et al., *U.S. Telecom Services Wireline*, Credit Suisse/First Boston, January 6, 2000, p. 34.

19. Opponents of the merger, however, challenge the competitive significance of these developments. First, they argue that emerging carriers lack sufficient brand name recognition to offer adequate substitutes, an issue we discuss in the next section.[11] Second, they argue that some emerging carriers do not provide alternatives for residential consumers because they do not serve the mass market.[12] This claim ignores the fact that a carrier can contribute to providing competitive alternatives to residential customers without itself serving residential customers directly. Carriers also contribute by providing a competing wholesale supply of leased circuits and switched capacity to others that do offer retail service to residential customers. Indeed, the emerging carriers, including those that opponents say do not serve residential customers, are active suppliers of wholesale services.

20. Third, opponents argue that emerging carriers lack sufficient geographic reach, which will hinder their ability either to provide service directly or to offer wholesale services.[13] The study presented by Professor Jerry Hausman purports to show the lack of reach of various emerging carriers' networks and the extent to which the merger would reduce the number of facilities-based carriers serving the U.S. population.[14] An analysis by Daniel Kelley and John O'Dwyer, however, finds that Hausman's study overstates how

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[11] Declaration of Dennis W. Carlton and Hal S. Sider, February 18, 2000 (hereafter "Carlton and Sider Declaration"), ¶¶ 16-17, filed as an Attachment to "Opposition of SBC Communications Inc.," *In re Applications of Sprint Corporation, Transferor, and MCI WorldCom, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Authorizations Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 1, 21, 24, 25, 63, 73, 78, 90, and 101*, FCC, CC Docket No. 99-333 (hereafter "Opposition of SBC"); see also Opposition of SBC, p. 16.

[12] Opposition of SBC, p. 16.

[13] See Opposition of SBC, pp. 17-20; and Declaration of Professor Jerry A. Hausman, February 18, 2000 (hereafter "Hausman Declaration"), ¶¶35-39, filed as an Attachment to Opposition of SBC Communications Inc.

[14] Hausman Declaration, ¶¶37-39 and Table 3.

much of the country would be served by a limited number of facilities-based carriers following the MCI WorldCom–Sprint merger.[15] The Kelley and O'Dwyer study finds that, after the merger, LATAs containing over 98 percent of U.S. households and access lines would be served by three or more facilities-based carriers, while LATAs containing 90 percent of U.S. access lines would be served by four or more carriers.[16] Furthermore, as Kelley and O'Dwyer point out, emerging carriers are continuing to add additional points of presence and to extend their networks to serve additional areas, and many of the LATAs now served by relatively few networks are quite close to fiber facilities controlled by additional carriers.[17] The development of new fiber networks is thus of great competitive significance, not for service in limited portions of the U.S. but for service throughout the country.

III. MASS MARKET CUSTOMERS

21. In the previous Besen and Brenner Declaration, we explained that high churn rates, with customers willing to switch carriers to obtain lower prices, are a fact of life for long distance carriers that compete to serve residential and smaller business customers.[18] We cited various studies and estimates of churn, some of which the Commission itself had

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[15] Declaration of Daniel Kelley and John O'Dwyer, March 20, 2000 (hereafter "Kelley and O'Dwyer Declaration"), filed as an Exhibit to MCI WorldCom and Sprint Corporation, "Reply to Comments and Petitions to Deny Application for Consent to Transfer Control," *In re Applications of Sprint Corporation, Transferor, and MCI WorldCom, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Authorizations Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 1, 21, 24, 25, 63, 73, 78, 90, and 101*, FCC, CC Docket No. 99-333.

[16] Kelley and O'Dwyer Declaration, ¶9.

[17] Kelley and O'Dwyer Declaration, ¶¶ 12-15.

[18] As in our previous Declaration, we organize our discussion around, without necessarily endorsing, the FCC's delineation of relevant markets as presented, for example, in "Memorandum Opinion and Order," adopted September 14, 1998, ¶24, *In the Matter of Application of WorldCom, Inc. and MCI Communications*

cited earlier, as evidence of customers' willingness to switch carriers in search of lower prices. We also concluded that emerging carriers have been net winners in this competition. They have both gained market share and been innovators in developing new services and marketing approaches.

22. Opponents of the merger, and economists filing on their behalf, challenge this view of market conditions. Emerging carriers, they argue, have not been very successful in winning customers. The ability of emerging carriers to win customers, the opponents argue, has been, and will continue to be, hindered by their lack of an established brand name and by an apparent unwillingness or inability of customers to seek out long distance plans with lower prices. In this section we address these and other issues raised by opponents that bear on competition for mass market customers.

A. The Success of Emerging Carriers

23. Contrary to the impression that opponents attempt to convey, carriers other than AT&T, MCI WorldCom, and Sprint have an impressive track record of success in selling long distance service to mass market customers using a variety of marketing approaches and techniques. The ability of emerging carriers to increase their market share steadily in a competitive marketplace bodes well for their ability to attract customers should a merged MCI WorldCom-Sprint attempt to exercise market power.

24. Opponents point to the fact that AT&T, MCI WorldCom, and Sprint have continued for some time to rank as the three carriers with the largest shares of long

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Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc., FCC, CC Docket No. 97-211.

distance residential toll service. Stability of rank, however, masks as much as it reveals, as can be seen from the table that Drs. Carlton and Sider present. Their table shows that carriers other than AT&T, MCI, and Sprint increased their share of presubscribed lines by 10.1 percentage points between December 1990 and December 1996, while AT&T lost 12.3 share points and MCI and Sprint together managed to grow only about 2 share points.[19] Moreover, as we pointed out in the prior Besen and Brenner Declaration, these trends continued after 1996. From 1995 to 1997, emerging carriers' share of residential access lines increased by 6.2 share points and their share of residential direct dial toll minutes increased by 7.9 share points.[20] Drs. Carlton and Sider argue that no individual carrier has become a major provider comparable in size to the three largest carriers. This ignores, however, the fact that the FCC's data we presented show that by 1997 the emerging carriers collectively had a larger share of residential long distance business than either Sprint or MCI.[21] The extent to which competitors can discipline a firm attempting to exercise market power depends on the collective ability and incentive of those competitors to take sales from the firm that raises price, not on how many sales any individual carrier can make.

25. Moreover, individual emerging carriers have shown an ability to gain share rapidly over relatively short periods. In doing so they also have demonstrated that a wide range of marketing approaches can be successful. To give one example, the number of access lines served by Excel Telecommunications increased from about 223 thousand to almost 3.8

[19] Carlton and Sider Declaration, Table 2, p. 7.

[20] Besen and Brenner Declaration, Table III-1, p. 30.

[21] Besen and Brenner Declaration, Table III-1, p. 30 and Figure III-2, p. 31.

million in just 18 months from June 1995 to December 1996.[22] Excel also reported that the long distance minutes it supplied grew from about 386 million in the second quarter of 1995 to about 1.8 billion in the fourth quarter of 1996, and continued to grow to about 2.9 billion in the fourth quarter of 1997.[23]

26. More recently, Talk.com has used e-commerce and partnerships—most notably with America Online—to spur rapid growth.[24] Talk.com claimed in January 1999 to have sold over 1.5 million long distance lines to AOL members since the 1997 launch of AOL Long Distance, its marketing agreement with AOL. Talk.com described this as "...the fastest market share shift in the long distance industry's history."[25] This is an example of both rapid growth and the possibility of utilizing marketing channels and brand identities from outside the telecommunications industry to promote that growth. In another example of an emerging carrier utilizing a market channel from outside telecommunications, American Express is offering its cardholders a long distance service branded as American Express Connections through an alliance with Qwest.[26]

27. The dial around services of MCI WorldCom also are examples of how "non-branded" service can succeed rapidly. MCI WorldCom launched its 10-10-321 (then 10-

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[22] James Zolnierek et al., "Long Distance Market Shares, Fourth Quarter 1998," March 1999, FCC, Industry Analysis Division, Common Carrier Bureau, Table 2.1, p. 5.

[23] Excel Communications Inc., SEC Form 10-K, filed March 30, 1998, and "Quarterly Results of Operations," SEC Form 10-Q, filed August 6, 1996, p. 11.

[24] Talk.com also has marketing agreements with First USA, Prodigy, Metris, CompuServe, and DSI; http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=talk&script=410&layout=-6&item_id=73435, visited February 26, 2000.

[25] Talk.com News Release – Tuesday, January 5, 1999, available at http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=talk&script=410&layout-6&item_id=22775, visited March 7, 2000.

[26] http://www.qhome.net/partner/xa0r/xa06/offerqmr01.jhtml, visited February 21, 2000.

321) dial around service in January 1997[27] and its 10-10-220 service in 1998.[28] By mid-1999, MCI WorldCom's dial around services were accounting for 3 percent or more of interLATA domestic direct dialed minutes.[29] MCI WorldCom markets these services without identifying them as MCI WorldCom services. The success of these services therefore provides an additional example of long distance services capturing sales and market share without taking advantage of any previously established equity from an AT&T, MCI WorldCom, or Sprint brand name.

B. Evidence on Residential Customer Purchase Patterns

28. Opponents of the merger, and economists filing on their behalf, attempt to paint a picture of competition to serve mass market customers in which customers do not often respond to changes in prices by changing carriers or pricing plans, and in which customers' choices are strongly influenced by brand loyalty and reputation. Economists filing on behalf of the opponents present analyses of pricing that purport to show that customers fail to take advantage of plans offered by their current carrier that would offer them better pricing, and that customers fail to shift to plans of emerging carriers that would offer them better prices.[30] They argue, further, that customers, faced with complex pricing plans, rely on brand names to make purchasing decisions.[31]

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[27] Beth Snyder, "MCI Touts Success of 10-321 Service," *Advertising Age*, November 10, 1997, p. 47.

[28] Frost & Sullivan, *The U.S. 10-10-XXX Dial-Around Services Market*, 1999 (Report No. 2014-63), p. 11-14.

[29] Calculated from Paragren Tele-Trend Call Detail Database (hereafter "Paragren Database"), January 1998 through October 1999.

[30] See Carlton and Sider Declaration, ¶¶23-31.

[31] See Carlton and Sider Declaration, ¶31.

29. In this section, we examine data on the switching of residential customers among long distance suppliers and the willingness of these customers to use the services of emerging carriers or others that do not carry an AT&T, MCI WorldCom, or Sprint brand name. These data are consistent with the view that we presented in the prior Besen and Brenner Declaration. First, there is a large amount of customer switching, and a substantial proportion of residential consumers do change the carrier they use for long distance service. Second, many residential consumers demonstrate a willingness to use a service that does not carry an AT&T, MCI WorldCom, or Sprint brand name.

30. This is not to say that all consumers instantly and always shift to the "best" plan available, but a firm's attempt to raise price and exercise market power can be unprofitable even if the firm loses far fewer than all of its customers. The questions are whether a sufficient number of customers are willing to switch carriers to render a price increase unprofitable, and whether a substantial number of customers would be willing to switch to a service without an AT&T, MCI WorldCom, or Sprint brand name if a merged MCI WorldCom-Sprint were to raise prices. Data on the extent and patterns of customer switching provide better evidence with which to answer these questions than do the data provided by Carlton and Sider.

31. Before turning to the data on residential customer switching patterns, however, we make a few observations about the two types of studies presented by Drs. Carlton and Sider. The first compares AT&T prices under a variety of plans with prices offered by Frontier, Excel, and Qwest, and concludes that most AT&T customers would save money if they switched to one of the other carriers. The second study attempts to compare what AT&T customers pay under the plan to which they subscribe to what they would pay under

other AT&T plans, and concludes that many AT&T customers would pay less under another AT&T plan. Both of these studies exhibit significant weaknesses.

32. First, both studies only consider AT&T customers, not customers of MCI WorldCom or Sprint. The brand loyalty of AT&T customers and their willingness to search out better pricing alternatives may well differ from that of MCI WorldCom and Sprint customers.[32] The brand loyalty of MCI WorldCom and Sprint customers is more important for predicting the effects of a merger between MCI WorldCom and Sprint than is the brand loyalty of AT&T customers, but the data presented by Carlton and Sider provide no evidence on this score.

33. Second, the study that attempts to compare AT&T's "best price" with that of other carriers relies on announced prices and does not take into account any special promotions or offers. Although such promotions and offers to switch carriers have been an important feature of competition for mass market customers, and although AT&T is known to have used promotions and special offers to attract customers, the calculations of best price provided by Carlton and Sider ignore the effect of such promotional offerings on the effective net price of service from AT&T under any of its plans.

34. Third, the analysis comparing what AT&T customers pay with what they would pay under other AT&T plans uses data on a household's calling in only a single month to calculate costs under different plans.[33] Carlton and Sider themselves acknowledge that their "results must be interpreted with caution" because calling patterns in a given month

[32] Carlton and Sider themselves argue that AT&T churn rates are substantially lower than churn rates for MCI WorldCom and Sprint. See Carlton and Sider Declaration, ¶34.

may not be representative of a customer's calling over a longer term;[34] the plan that appears to offer the lowest cost in a particular month may not be the best plan for that customer over the longer term. Furthermore, Carlton and Sider calculate the cost of different plans based on households' usage in October, November, or December of 1998. There is considerable seasonality in residential calling patterns, and average minutes of calling per household during these particular months, especially in December, were relatively high.[35] This is further reason for being cautious about concluding that a calculation based on usage in these individual months indicates accurately which plan would be lowest cost for customers over the longer term.

DATA ON RESIDENTIAL CUSTOMER BEHAVIOR

35. We have used Paragren Tele-Trend Call Detail data to analyze the choices made by residential customers among telecommunications carriers. This sample provides detailed call information for approximately 2,000 to 5,000 households each month from January 1998 through October 1999. Paragren codes call detail data for a demographically balanced subset of its Tele-Trend Panel, which it describes as a consumer panel of nationally representative households.[36] Importantly for present purposes, most of the sample consists of households whose use of long distance is tracked for multiple months. This allows one to observe how often households change the long distance carrier they use as well as the patterns of those changes. Households are retained in the sample for varying

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[33] It is virtually impossible to follow a specific household's usage of long distance across multiple months with the PNR data that Carlton and Sider employ for their analysis.

[34] Carlton and Sider Declaration, ¶31.

[35] Examination of PNR data confirms that the average minutes of direct-dialed domestic interLATA calls per household were relatively high in these months.

[36] Paragren, "Tele-Trend Call Detail Users Guide," p. 2.